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No. 88-1451

In the Supreme Court of the United States

OCTOBER TERM, 1988

HOWARD M. LEVY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

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QUESTION PRESENTED

Whether the false statements made by petitioner on certain corporate tax returns were material under 26 U.S.C. 7206(1) if providing true information would not have increased the corporation's tax liability, but could have increased the tax liability of a related entity.

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OPINION BELOW

The opinion of the court of appeals (Pet. App. A1-A10) is unpublished, but the decision is noted at 862 F.2d 305 (Table).

JURISDICTION

The judgment of the court of appeals was entered on September 13, 1988. A petition for rehearing was denied on November 1, 1988 (Pet. App. A13). The petition for a writ of certiorari was not filed until February 16, 1989, and is therefore out of time under Rule 20.1 of the Rules of this Court. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

Following a jury trial in the United States District Court for the District of Connecticut, petitioner was convicted

on one count of conspiracy to defraud the United States, in violation of 18 U.S.C. 371, two counts of filing false tax returns, in violation of 26 U.S.C. 7206(1), and 37 counts of aiding and assisting in the preparation of false tax returns, in violation of 26 U.S.C. 7206(2). Petitioner was sentenced to six years' imprisonment, five years' probation, and a $30,000 fine. The court of appeals affirmed (Pet. App. A1-A10).

1. The evidence at trial showed that petitioner created a tax shelter scheme that enabled "investors" to claim investment tax credits, energy credits, and depreciation relating to nonexistent assets. The scheme involved a limited partnership, Clinton Energy Associates (Clinton), and a corporation, Midland Alcohol Fuels, Inc. (Midland). Petitioner was an officer of Midland and a partner in Clinton. Through a circular transaction, Midland purported to borrow $8.78 million from a Mexican company called Empresas Interamericanas Consolidadas (Empresas), and in turn purported to lend $8.78 million to Clinton. Gov't C.A. Br. 8-12. Petitioner listed the $8.78 million note from Clinton as an asset and the $8.78 million note to Empresas as a liability on Midland's tax returns for its taxable years 1981 and 1982. Gov't C.A. Br. 42. Clinton, in turn, listed buildings and other depreciable assets having a value of more than $9.3 million on its returns for taxable years 1981 and 1982 (Gov't C.A. Br. 16-17, 19-20). The partners in Clinton, including petitioner, claimed investment tax credits, energy credits, and depreciation based on schedules K-1 from Clinton reflecting credits and deductions from assets Clinton did not own (Gov't C.A. Br. 14, 16-17).

2. On appeal petitioner contended, inter alia,[1] that the trial court erred when it found that the claim of a sham

[1] Petitioner also argued that the district court had improperly questioned a government witness and that the court erred in failing to give

$8.78 million asset and offsetting liability on Midland's returns constituted a material matter under 26 U.S.C. 7206(1).[2] The court of appeals affirmed (Pet. App. A1-A10). The court rejected (Pet. App. A8) petitioner's argument that the listed items were not material because they resulted in no change in the tax liability of Midland. Relying on *United States* v. *Greenberg*, 735 F.2d 29, 31 (2d Cir. 1984), the court held that a misstatement on a return that "potentially hinders the Internal Revenue Service in verifying the accuracy of that return or a related tax return" violates 26 U.S.C. 7206(1). Contrary to petitioner's contention, the court concluded that this Court's discussion of materiality in *Kungys* v. *United States*, 108 S. Ct. 1537 (1988), "which was decided in another context," did not undermine the "straightforward and clearly applicable rule" of *Greenberg* (Pet. App. A8-A9).

ARGUMENT

1. Petitioner asserts (Pet. 12) that the false statements regarding a debt and an offsetting asset on the Midland tax returns had absolutely no bearing on the calculation of Midland's income, expenses, or tax liability. He argues (Pet. 9-10) that the Second Circuit erred in adopting a theory of materiality that permits a jury to convict under

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a jury instruction on falsity under 26 U.S.C. 7206(1). The court of appeals rejected those arguments (Pet. App. A3-A8), and petitioner has not renewed them in this Court.

[2] Section 7206(1) provides, in pertinent part, that a person shall be guilty of a felony who

> [w]illfully makes and subscribes any return * * * which contains or is verified by a written declaration that it is made under penalties of perjury and which he does not believe to be true and correct as to every material matter.

26 U.S.C. 7206(1) on the basis of false statements that are material to a tax return other than the one on which the statements appear. Petitioner's erroneous theory of materiality was correctly rejected by the court of appeals.

Section 7206(1) is not a statute that prohibits tax evasion, but a perjury statute that safeguards the "self-assessment nature of our tax system." *United States* v. *Taylor*, 574 F.2d 232, 236 (5th Cir.), cert. denied, 439 U.S. 893 (1978). It is designed to punish "those who willfully falsify their returns regardless of the tax consequences of the falsehood." *United States* v. *Lodwick*, 410 F.2d 1202, 1205-1206 (8th Cir.), cert. denied, 396 U.S. 841 (1969) (quoting *Gaunt* v. *United States*, 184 F.2d 284, 288 (1st Cir. 1950), cert. denied, 340 U.S. 917 (1951)). Every court of appeals to consider the issue has agreed that the test for materiality is not whether the statement affects the computation of tax liability, but whether the falsified information "is essential in order to permit the [IRS] to verify and monitor the reporting of income." *United States* v. *Taylor*, 574 F.2d at 235-236; *United States* v. *Greenberg*, 735 F.2d 29, 31-32 (2d Cir. 1984) ("materiality refers to the impact that the statement may reasonably have on the ability of * * * [the] agency to perform the functions assigned to it by law"); *United States* v. *Holecek*, 739 F.2d 331, 337 (8th Cir. 1984), cert. denied, 469 U.S. 1218 (1985); *United States* v. *DiVarco*, 484 F.2d 670, 673 (7th Cir. 1973), cert. denied, 415 U.S. 916 (1974); see also *United States* v. *Romanow*, 509 F.2d 26, 28 (1st Cir. 1975); *United States* v. *Abbas*, 504 F.2d 123, 126 (9th Cir. 1974), cert. denied, 421 U.S. 988 (1975).

Petitioner does not deny that the sham loan entries on Midland's returns had the potential to obstruct the IRS's investigation of the tax liability of Clinton Energy Associates. Petitioner's sole contention is that these false statements could not be material under Section 7206(1)

unless they had the potential to impede the investigation and verification of taxes due with respect to the return on which the false statements appeared. In essence, petitioner contends that statements on one return that might obstruct the investigation of another return can never be material. But there is nothing in the statute or the case law that limits the scope of materiality to the four corners of the return that includes the false statement.[3]

As this case demonstrates, the crabbed view of materiality that petitioner proposes would undermine the IRS's attempts to investigate complex tax fraud schemes.[4] Here, the IRS's concern was not confined to a determination of Midland's tax liability. The IRS was investigating the legitimacy of a tax shelter scheme that involved Midland and Clinton as well as numerous investors/partners. The assertion on Midland's returns that it loaned Clinton $8.78 million and borrowed the same amount from Empresas clearly was capable of influencing the IRS's assessment of the validity of the shelter, since it made

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[3] Petitioner relies (Pet. 10) on *United States* v. *Null*, 415 F.2d 1178 (4th Cir. 1969), and *United States* v. *Warden*, 545 F.2d 32 (7th Cir. 1976), to support his contention that materiality is tested by whether a misstated item is essential to a correct tax estimate on the same return. In both of those cases, however, the false statements at issue affected the computation of the liability. Neither court considered the materiality of statements that did not affect the taxpayer's liability but nevertheless tended to impede the IRS's ability to conduct a tax investigation involving other returns.

[4] In addition, petitioner's narrow construction of the requirement of materiality under 26 U.S.C. 7206(1) would lead to the implausible conclusion that false statements made on a partnership return or a return of a subchapter S corporation could never be material under Section 7206(1), as such entities incur no tax liabilities, even though the information on those returns, like the information at issue in this case, is important to the determination of the tax liability of related entities and individuals.

more believable Clinton's assertion that it owned more than $9 million worth of alternative energy equipment. The potential of these statements to mislead the IRS clearly satisfies the established test for materiality under Section 7206(1).

2. The false statements on Midland's returns were obviously material under the test applied in *Kungys* v. *United States*, 108 S. Ct. 1537 (1988). As the Court explained in *Kungys*, a misrepresentation is material if it has a natural tendency to influence or was capable of influencing a determination by the decisionmaking body to which it was submitted (*id.* at 1547). The potential of a statement to influence an inquiry must be judged by "the central object of the inquiry" conducted by the decisionmaker (*ibid.*). In this case, "the "relevant official inquiry" was not, as petitioner erroneously contends (Pet. 12), "Midland's tax liability," but the legitimacy of the entire tax shelter scheme that included Midland and other entities. The false statements on Midland's returns plainly had the potential to hinder that investigation.

Petitioner relies (Pet. 14) on the statement in the plurality opinion in *Kungys* that "[w]hat must have a natural tendency to influence the official decision is the misrepresentation itself, not the failure to create an inconsistency with an earlier misrepresentation." 108 S. Ct. at 1549. Petitioner contends that, under that standard, the statements regarding the sham Midland loan entries cannot be material, because those statements would tend to hinder the IRS's investigation only by virtue of their failure to "create an inconsistency" with other similar false entries on the Clinton return.

The flaw in this argument is its failure to take into account the decisionmaking task in *Kungys* against which the materiality of the false statements was evaluated. In *Kungys*, the question was whether the plaintiff's natural-

ization certificate was procured by "concealment of a material fact" in violation of 8 U.S.C. 1451(a). In interpreting that statute, the Court recognized that the "scope of the inquiry" concerning materiality was whether the false statement would tend to influence the naturalization decision. The Court held that a misrepresentation as to the plaintiff's date and place of birth, which it concluded would not tend to affect the decision in the naturalization proceeding, did not become material simply because the same immaterial false statement had been made in an earlier and entirely separate visa proceeding.[5]

In *Kungys*, therefore, the false statement at issue was found immaterial because it could influence the naturalization decision only when compared with a statement made in an extraneous context. In this case, by contrast, sham loan entries on the Midland returns made the tax shelter scheme appear legitimate by virtue of their consistency with other statements that were clearly relevant to the IRS's investigation. Here, there were not separate, unrelated proceedings, but, rather, one unified examination of the validity of a tax shelter scheme involving both Midland and Clinton. The "scope of the inquiry" into this scheme plainly encompassed statements on both Midland's and Clinton's returns and permitted their comparison. Midland's false statements therefore had the potential to

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[5] As the plurality further explained in *Kungys*, 108 S. Ct. at 1549, "what is relevant is what would have ensued from official knowledge of the misrepresented fact, * * * not what would have ensued from official knowledge of inconsistency between a posited assertion of the truth and an earlier assertion of falsehood." In *Kungys*, nothing would have ensued from official knowledge of Kungys's true date and place of birth, while in this case, the inclusion of true information on Midland's return could well have had a very significant consequence—the disclosure of important misrepresentations on Clinton's return, and ultimately the unraveling of the entire fraudulent scheme.

influence the IRS in the course of its inquiry and were clearly material.

CONCLUSION

The petition for a writ of certiorari should be denied.

Respectfully submitted.

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